

TESTIMONY OF
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BEFORE
SENATE BUDGET COMMITTEE

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Thank you Mr. Chairman, Senator Domenici and Members of the Committee.

I appreciate the committee's invitation and this chance to discuss the nation's constantly shifting fiscal situation. Permit me to start by noting the persistence of two striking phenomena that distinguish today's environment from any we have seen: first, a tremendously positive national fiscal condition despite a nearly stagnant economy; second, a strong bipartisan agreement to preserve very large surpluses as a threshold condition of public finance.

I am glad to report that, in stark contrast to past economic turndowns, the nation's finances are in remarkably strong shape. Even in the midst of a year-long slowdown in the economy, we continue to accumulate enormous surpluses, and to use the extra receipts to steadily reduce the nation's outstanding public debt.

This is an historical phenomenon without precedent in modern times; the almost invariable pattern is for countries to run deficits, often very large ones, during economic difficulty. In all modern U.S. slowdowns, the nation has run in the red, often by very large amounts. In 1982, the deficit was \$128 billion, or 3.4% of GDP. In 1992, the deficit reached \$290 billion. By contrast, this year we will enjoy the second largest surplus in American, which is to say, world history.

But in the last few years, a unique bipartisan consensus has arisen in our country, one at variance with preceding economic theory. In large part due to the work of this committee, notably its chairman and ranking member, an agreement has been forged to run very large surpluses as a matter of course, in strong economic times or in weak. Both parties and both the legislative and executive branches, in this administration and the previous one, have concurred in maintaining a surplus at least the size of the Social Security surplus.

Many would like to set the minimum surplus level even higher, using as a target the artificial overage in the Medicare Part A trust fund. This is a relatively modest difference, amounting to whether the minimum surplus should be more like 8% or 9% of revenues, some \$160 billion or closer to \$190 billion. Between those two figures lie some hard disagreements, to be sure, but that should not obscure the radically different nature of the current situation and the new consensus.

It is fascinating to note how far this consensus departs from traditional economic thought. Only yesterday, slowdowns were said to call for deficit finance, for governments to take in less in taxes than they spent. The nation conducted a decades-long, spirited debate about the wisdom of a balanced budget amendment to the Constitution. Now, suddenly, we find ourselves in strong and healthy agreement on maintaining a fiscal position vastly stronger than the mere balance such an amendment would have required.

Whatever differences may prove to separate us during the course of this morning's hearing, I hope we can all agree that the matter of most urgency must be the resuscitation of economic growth in our country. The President and a bipartisan Congressional majority agreed to utilize a portion of our unified surpluses to try to stimulate the economy through tax relief, and that action came just in time. I am submitting for the record the comments of a host of economists forecasting a boost to growth stemming from the tax cut ranging from 3/4% to 1 1/4% in the second half of this year. Just this week, the Blue Chip Consensus of the nation's top analysts expressed this view, writing "The tax cut effects could not have come at a better time..."

Mr. Chairman, you have asked for an update on our fiscal expectations. I can report that we see continued large surpluses at least at the size of the Social Security surplus for all years in the budget horizon. The President is determined to preserve surpluses at this level, and to continue using these funds for the steady reduction of outstanding national debt, a cause of which you are a leading champion.

In the 2001 fiscal year now winding down, we are of course dealing with the budget agreed to by the last Congress and the last President. That budget, passed last December, contained the largest one-year spending increase in history; obviously, a smaller surge in spending would have ensured a larger surplus today. But the major reason for a surplus that is merely immense, rather than gigantic, is of course a shaky economy.

Due to the dramatic economic slowdown, starting about a year ago but not fully measured until the last few months, revenues for the current fiscal year will grow more slowly than previously forecast, on the order of +3% rather than the expected +5% or more. Because OMB was overly cautious in estimating outlay rates, 2001 spending will also be somewhat lower than expected, and the net change in the surplus will be somewhat less than the drop in revenue.

I would point out that, in missing by 2-3%, this year's revenue forecast was substantially more accurate than its recent predecessors. Also, please note that all OMB projections of economic growth and revenue growth have been completely in line with those of the Congressional Budget Office, the Blue Chip private consensus, and other private estimates. When we produce our Midsession Review later this summer, once again we will use future estimates that match closely the most credible third party predictions available. Such forecasts are always destined to miss by some margin, but we take it as our duty to work with well-founded assumptions and to strive for accuracy as far as is humanly

possible.

The Social Security surplus makes a good target for several reasons. First, unlike Medicare, or Military Retirement, or Civil Service Retirement, or many other of the government's 100-plus other trust funds, Social Security is in true surplus for the moment, taking in more than the program costs. Secondly, there is some symbolic value in reaffirming the special commitment we all share to protecting older Americans. Third, the President and a majority of Americans hope for reform that converts a portion of Social Security receipts from a mere IOU to real assets, owned by the worker who paid those taxes. At that point, the notion of a "lockbox" will take on real, literal meaning.

But the best reason for choosing this surplus target versus any other arbitrary goal is that, as we apply these amounts to debt reduction, we achieve with some room to spare the maximum amount of such reduction possible. Over the next ten years, Social Security will take in excess funds of some \$2.5 trillion, whereas maximum debt retireable without incurring unjustifiable premium expenses is about \$2.2 trillion. This year, we will eliminate over \$100 billion of existing debt, marking the fourth year in a row of such reductions, and further such shrinkage is scheduled for each succeeding year. This is an important accomplishment for which both political parties, both branches of government, and both the last two administrations all deserve credit.

So the nation's finances are in extremely sound condition. Only persistent, long-term economic weakness can threaten this position, so promoting a return to vigorous growth must be our common objective. The best course forward is clear: first, pass this year's appropriations at the level of the 2002 Budget Resolution, including the defense amendment recently proposed by the President.

Second, work together to continue restraining total spending in the next few years. Businesses, states, cities, and families have no hesitation to limit their spending when revenues subside. The fifty state governments recently reported that collectively they are lowering spending growth from nearly 8% last year to around 3% in FY 2002. Spending in the domestic agencies exploded during the last three years, including growth of 45% at HHS and 27 % at DOT. These departments can benefit from a period of digestion without great growth beyond these expanded levels.

Restraint does not mean paralysis. We can make room for new initiatives, and for reasonable spending growth in good programs by finally becoming serious about the review of antiquated, duplicative, and non-performing programs. We must reverse the bizarre presumption, which operates nowhere else in life, that the burden of proof rests with those who challenge any penny of current spending. As in any business or family, the burden must be placed on those accountable to justify the ongoing value of whatever money is being spent today. Any healthy organization constantly searches for ways to redeploy money from less efficient to more efficient purposes; we must weed the garden if new plants are to sprout and flourish.

Finally, we must be prepared to collaborate on additional moves to strengthen the economy. This might involve approaches unrelated to fiscal policy; trade liberalization, and the alleviation of paperwork or other regulatory burdens come to mind.

Mr. Chairman, I commend your concern in calling this hearing, and your vigilance in seeking to make sure that today's hard-earned fiscal vitality is preserved. I am pleased to be able to report the strength of our position, but also to associate with your determination to take nothing for granted and to see that progress continues in both the near and long terms.